

TENNESSEE REGULATORY AUTHORITY

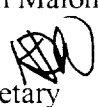
Lynn Greer, Chairman
Sara Kyle, Director
Melvin Malone, Director



460 James Robertson Parkway
Nashville, Tennessee 37243-0505

MEMORANDUM

TO: Chairman Lynn Greer
Director Sara Kyle
Director Melvin Malone

FROM: David Waddell 
Executive Secretary

DATE: February 13, 1997

RE: BellSouth Entry into Long Distance (Section 271 of the Federal Telecommunications Act of 1996)

Attached is the staff report on the above, which you requested on December 17, 1996. It concludes, and the parties agree, that BellSouth is not yet in compliance with the requirements of Section 271.

Not surprisingly, there is wide disagreement between BellSouth and the new entrants on what needs to be done to achieve compliance. Even with all the right words in an interconnection agreement, the new entrants want to see evidence that BellSouth is doing what they have agreed to do, before they are allowed into long distance. If this is not done, they do not believe that local competition will emerge as the law intended. BellSouth feels otherwise.

A question you will be asked to decide is whether a formal contested case is required for you to make an informed recommendation to the FCC on this matter. The staff is not convinced that it is. The tradeoff is the additional knowledge gained from such a proceeding versus the time required to conduct the proceedings. You of course must decide what you are comfortable with in making what is clearly a major decision.

In the coming months, the staff anticipates a contested case will be initiated to set permanent rates to replace the proxy prices set during arbitration. We see this as an important element of Section 271 compliance. Again, the TRA will be faced with a balancing act on how to allocate its time and resources.

For the TRA Conference on February 18, 1997, we recommend that you accept the staff report and take it under advisement. Should you determine that a contested case is warranted for 271 resolution, you should announce it as soon as possible to allow an orderly schedule to be prepared.

Attachment

TRA STAFF REPORT

BELLSOUTH ENTRY INTO LONG DISTANCE SERVICES (INTERLATA) IN TENNESSEE

SECTION 271 THE FEDERAL TELECOMMUNICATIONS ACT OF 1996

February 18, 1997

*THE VIEWS EXPRESSED IN THIS REPORT ARE THOSE OF THE TRA STAFF
AND DO NOT NECESSARILY REFLECT THOSE OF THE DIRECTORS*

The Tennessee Regulatory Authority

**BELLSOUTH ENTRY INTO LONG DISTANCE SERVICES (INTERLATA) IN TENNESSEE
SECTION 271 OF THE FEDERAL TELECOMMUNICATIONS ACT OF 1996**

**A REPORT BY THE STAFF OF
THE TENNESSEE REGULATORY AUTHORITY
FEBRUARY 18, 1997**

***THE VIEWS EXPRESSED IN THIS REPORT ARE THOSE OF THE TRA STAFF AND DO NOT
NECESSARILY REFLECT THOSE OF THE DIRECTORS.***

1.0 BACKGROUND

Among the many telecommunications issues treated in the Telecommunications Act of 1996 (the "Act"), were the conditions under which BellSouth would be allowed to enter the interLATA long distance market in Tennessee (section 271). Such an application would be made by BellSouth to the Federal Communications Commission (FCC). The FCC must approve or deny such an application within 90 days of its receipt. During this 90 day period of consideration, the FCC must consult with the Attorney General of the United States, and the Tennessee Regulatory Authority (TRA). The TRA consultation is to determine if BellSouth has complied with the requirements of subsection 271(c) of the Act in Tennessee.

The FCC has advised the State Regulatory Commissions that they will require inputs from the states within 20 days of such an application by a Bell Operating Company (e.g. BellSouth) in order to meet their 90 day deadline. In December 1996, BellSouth informally advised the TRA that they expected to file such an application for interLATA service entry in Tennessee "shortly." To prepare for such a situation, the TRA Directors asked their staff at the December 17, 1996 Sunshine (i.e. Public) Conference, to examine the requirements of subsection 271(c) and report back to them on the current situation in Tennessee. This report is intended for that purpose. On January 31, 1997, a draft of this report was sent to BellSouth and all certificated facilities-based providers of local telephone service in Tennessee for review and comment. Comments received are included as Appendices A through H of this report.

2.0 THE STAFF APPROACH

The Chiefs of the appropriate TRA Divisions and the General Counsel met on December 18, 1996 to plan the work activity. Two major provisions of subsection 271(c) deal with a 14 point checklist which BellSouth was required to meet, and the status of competitive facilities-based providers of local telephone service in Tennessee. In addition, although it is not addressed in 271(c), the staff believed it also had a responsibility to examine the public interest issues associated with this issue. The staff also invited the Tennessee Consumer Advocate Division to offer its thoughts on public interest issues (Attachment 4). The FCC is required to consider this under

subsection 271(d) (3) (C), and they have said that they would welcome input from the states in this area.

2.1 The 14 Point Checklist

During the last half of 1996 and into January 1997, the TRA was engaged in extensive arbitration proceedings between BellSouth and AT&T, MCI, and Sprint. Among the issues presented for arbitration were 13 of the 14 items covered in the Federal Checklist. Since an extensive record was developed during these proceedings, including the views of all the parties to the arbitration on these checkpoint issues, the staff believed that this combined with the arbitration decisions, would eliminate a need to ask for further information from these parties. Also available to the staff were 6 approved interconnection agreements between BellSouth and new local service providers who were certificated in Tennessee. This material was used in analyzing 13 of the checkpoint issues.

The one issue not addressed during arbitration was a checklist item pertaining to local dialing parity. The staff discussed this point with BellSouth in preparing this report.

2.2 Facilities-Based Competition

Currently, there are 19 companies certificated in Tennessee to offer competitive, facilities-based local telephone service. The staff agreed to contact all of these companies during January 1997 to determine their current status.

2.3 The Public Interest

Allowing BellSouth to enter the interLATA market is consistent with the Tennessee state policy of: "permitting competition in all telecommunications markets." Serving the public interest requires the consideration of existing competition in both the long distance and local markets, and the likely competitive effects of BellSouth's entry into the long-distance market. The staff agreed to also examine this issue in the preparation of this report.

3.0 BELLSOUTH COMPLIANCE WITH THE 14 POINT CHECKLIST

In the language of the law, the 14 point competitive checklist is stated in the following fashion:

1. **Interconnection** in accordance with sections 251(c)(2) and 252(d)(1).
2. **Nondiscriminatory access to network elements** in accordance with the requirement of sections 251(c)(3) and 252(d)(1).

¹ Tennessee Code Annotated §65-4-123

3. **Nondiscriminatory access to poles, ducts, conduits, and rights-of-way** owned or controlled by the Bell operating company **at just and reasonable rates** in accordance with section 224.
4. **Local loop** transmission from the central office to the customer's premises, **unbundled from local switching** or other services.
5. Local transport from the **trunk side** of a wireline local exchange carrier switch **unbundled from switching** or other services.
6. **Local switching unbundled from transport, local loop** transmission, or other services.
7. **Nondiscriminatory access to 911 and E911** services; **directory assistance** services to allow the other carrier's customers to obtain telephone numbers; **and operator call completion services**.
8. **White pages directory listing for customers of the other carrier's** telephone exchange service.
9. Until the date by which telecommunications numbering administration guidelines, plan, or rules are established, **nondiscriminatory access to telephone numbers** for assignment to the other carrier's telephone exchange service customers. After that date, compliance with such guidelines, plan, or rules.
10. **Nondiscriminatory access to data bases and associated signaling** necessary **for call routing and completion**.
11. Until the date by which the TRA issues regulations pursuant to section 251 to require number portability, **interim telecommunications number portability** through remote call forwarding, direct inward dialing trunks, or other comparable arrangements, with as little impairment of functioning, quality, reliability, and convenience as possible.
12. Non discriminatory access to such services or information as are necessary to allow the requesting carrier to implement **local dialing parity** in accordance with the requirements of section 251(b)(3).
13. **Reciprocal compensation** arrangements in accordance with the requirements of section 252(d)(2).
14. Telecommunications services are available for **resale** in accordance with the requirements of sections 251(c)(4) and 252(d)(3).

In resolving issues by arbitration, the TRA was required to ensure that the requirements of section 251 of the Act were met, and rates established according to

252(d). Checklist item 3 also refers to section 224 in determining just and reasonable rates. Sections 252(d) and 224 call for rates to be based on cost.

The Act set strict limits on the time available to state commissions to conclude arbitration. In Tennessee these conclusion dates were December 4, 1996 for AT&T; December 26, 1996 for MCI; and January 15, 1997 for Sprint. During this arbitration period, there was considerable turmoil on the subject of how the cost studies should be done to establish rates under the Act. The FCC issued rules which addressed this matter on August 8, 1996. These rules were appealed however and a stay was granted by the U.S. Court of Appeals on the portion of the rules which addressed pricing. To complete their work on time, the TRA Directors, acting as arbitrators, were forced to establish proxy prices where no appropriate cost studies were available. Checklist items 1 (Interconnection), 2 (Network Elements), 3 (Poles, ducts, conduits and rights-of-way) and 13 (Reciprocal Compensation) required the use of proxies in the absence of appropriate cost studies.

While the proxy rates may be helpful in executing early interconnection activity, the staff believes that the law is quite clear in its intent to have the rates for these 4 checklist items (i.e. 1, 2, 3, and 13) based on cost. For this reason, the staff believes that BellSouth should not be certified as in compliance with these items until new cost studies are complete, and permanent rates set. Since there will continue to be uncertainty associated with the cost study issue until the Appeals Court makes a decision, the staff proposes a schedule tied to the date of that decision:

Appeals Court Decision	Date
TRA Requests Cost Studies	Date + 15 days
BellSouth Submits Studies	Date + 75 days
Hearing Direct Testimony Due	Date + 150 days
Rebuttal Testimony Due	Date + 160 days
Hearing	Date + 170 days
Decision	Date + 185 days

This 6 month period reflects the staff's current judgment on an orderly process to set rates. It is anticipated that this will be refined after the Court's decision is made, and in consultation with the parties.

The staff believes that the TRA has the authority to specify how the cost studies should be conducted. The Appeals Court is examining the appropriate role of the FCC with respect to cost studies. Since oral argument was held by the 8th District Court of Appeals on January 17, 1997, there is reason to expect a decision on this high profile case shortly. The staff believes it would be prudent therefore to await such a decision. The possibility of subsequent appeals is also recognized. The staff does not believe however that initiation of cost studies should be postponed until all legal challenges are exhausted. The delays associated with such an approach would also delay the emergence of further competition in both the local and long distance telephone markets.

Based on the staff's review of the arbitration record and the interconnection agreements, BellSouth is judged to be in compliance with checklist items 4, 5, 6, 7, 8, 9, 10, 11, and 14 (For a synopsis of the staff's 14 point analysis see Attachment 1).

In response to a staff request, BellSouth provided the TRA with their plans for complying with the local dialing parity issue (checklist item 12). This plan is included as (Attachment 2) to this report. Upon implementation of this plan, the staff concludes that BellSouth will be in compliance with checklist item 12.

4.0 FACILITIES-BASED COMPETITION IN TENNESSEE

Section 271(c)(1) of the Act establishes another requirement which BellSouth must meet to begin offering long distance services in Tennessee (i.e. interLATA Services). That requirement is the presence of a facilities-based competitor in Tennessee (subsection A), or lacking that, a TRA approved statement of terms and conditions which would be offered to such a provider (subsection B).

Since the passage of the new Tennessee Telecommunications law in 1995, the Public Service Commission, and later the TRA, has been tracking the evolution of local exchange competition statewide. To address the specific issue of facilities-based competition, all 19 new companies certificated to offer facilities-based local telephone service in Tennessee were contacted during January 1997. (Attachment 3).

Subsection (A) of 271(c)(1) defines facilities-based providers as those providing telephone exchange service to residential and business subscribers predominantly over their own facilities. Within Tennessee, no company other than an incumbent telephone company, is currently offering facilities-based local services to residential customers. Only one company is currently offering facilities-based local service to business customers in competition with the incumbent telephone company. NEXTLINK has been serving business customers in Memphis and Nashville in competition with BellSouth, since July 4, 1996. Currently, they support several hundred business lines in each city.

Since BellSouth currently has no competition in Tennessee from a facilities-based provider in offering residential local exchange service, the staff does not believe it has met the conditions of subsection (A) of 271(c)(1). That leaves subsection (B).

BellSouth can meet the requirement of 271(c)(1), if no facilities-based provider has requested the access and interconnection covered in subsection (A), and the TRA has approved or permitted to take effect a statement of the terms and conditions that BellSouth will offer to companies wishing to be facilities-based providers. BellSouth has not filed such a statement with the TRA. If and when it does, the TRA will have 60 days to complete its review, or permit such statement to take effect while it completes its review.

Based on the staff's analysis of the current situation, BellSouth has not yet complied with the requirements of section 271(c)(1) for entry into the interLATA services market in Tennessee.

5.0 THE PUBLIC INTEREST IN TENNESSEE

Serving the public interest requires the consideration of existing competition in both the long distance (interLATA) and local telephone markets (intraLATA). BellSouth's entry into the long distance market in Tennessee and throughout their nine state region, will be quite a dramatically different experience than that of long distance companies and others moving into the local telephone market. BellSouth can enter their regional long distance market almost on their own. They have an existing interLATA network which they have used for years for their internal communications. This experience and their years of planning to enter this long distance market should allow rapid market entry without significant dependence on competitors. Nobody attempting to enter the local market is similarly positioned. Extensive support from BellSouth in terms of interconnection and resale agreements will be essential for market entry. The price for BellSouth entry into long distance is the opening of their local markets. If such entry is permitted before local markets are truly open to competition, BellSouth's motivation for complying with competitors interconnection requests diminishes. This is why special consideration must be given to the timing of BellSouth's entry into the long distance market. Meanwhile we should at least be aware of the interexchange carriers' (IXCs') incentive to delay BellSouth's entry into interLATA services.²

5.1 The Long Distance Market

In the thirteen years since the breakup of the Bell System, the long distance industry has evolved into one which is still dominated by a small set of facilities-based providers. AT&T and MCI account for almost 82% of the interLATA market as measured by 1995 Tennessee intrastate revenues. While industry structure does have competitive implications, more pertinent to the public interest rationale behind allowing RBOC entry into long distance is the actual degree of price competition in the long distance market. Maintaining a trend seen in recent years, the December 1996 interstate rate increases introduced by AT&T were rapidly followed by similar increases from MCI and Sprint. The suspicion continues that the public is not benefiting very much from price competition in the long distance market.³

In the current long distance environment, the entry of BellSouth and the other large Regional Bell Companies can have significant pro-competitive effects. They have facilities in place, a large telephone customer base, and significant engineering and marketing expertise. BellSouth will be well positioned to offer "one stop shopping" to its customers. In a recent press article, the company stated that it "expects to attract 20% of the Southeast's \$8 billion long distance market and keep most of the local business

² Dennis L. Weisman, "Regulation and the Vertically Integrated Firm: The Case of RBOC Entry into InterLATA Long Distance," *Journal of Regulatory Economics* 8:3 (November 1995).

³ Paul W. MacAvoy, "Tacit Collusion Under Regulation in the Pricing of Interstate Long-Distance Telephone Services," *Journal of Economics & Management Strategy* 4:2 (Summer 1995). See also Harry M. Shooshan (ed.) *Disconnecting Bell: The Impact of the AT&T Divestiture*, Pergamon: 1984. As MCI points out, this is an unresolved issue in the economics literature. For an opposite point of view see Simran K. Kahai, David L. Kaserman, and John W. Mayo, "Is the 'Dominant Firm' Dominant? An Empirical Analysis of AT&T's Market Power," *Journal of Law and Economics* 39:2 (October 1996).

once it's finally cleared for unrestricted service."⁴ Such an opportunity must also be open to competitors. The public interest will not be served well if BellSouth or other local telephone companies are allowed to exploit their control of bottleneck local exchange service.⁵

Access to long distance services is provided to businesses today by a number of companies in addition to the local telephone company. So-called competitive access providers (CAPs), which use their own facilities to directly connect customers to the long distance networks, are a growing and successful new entrant to the telecommunications industry. A number of these CAPs serve major cities in Tennessee today, and the list is growing. They are well represented on the list of 19 companies certificated to offer facilities-based local service in Tennessee today. Only NEXTLINK, however, is currently offering local exchange as well as CAP services.

Long distance resellers also are playing an important role in bringing lower priced services to the public. During 1996, the TRA authorized 90 new companies to enter this business. These resellers must purchase their services from facilities-based providers. To the extent that new facilities-based providers such as BellSouth introduce more price competition in interLATA services, resellers and their customers would also benefit.

5.2 The Local Telephone Market

Opening the local telephone market to competition is what the new federal and state telecommunications laws are all about. Evidence to date has been that this will be "slow going." The once aggressive cable television industry has reversed course and is backing away from near term entry into the local telephone market. Likewise, the long distance companies have extended their time lines for entry into the local market. Those who have entered the business are struggling to provide a quality of service which their customers have grown to expect. Technology may have opened doors, but there are a lot of "real world" business problems to deal with in entering the local telephone market. From the evidence received, very few Tennesseans will see alternatives to the incumbent local telephone company during 1997.

6.0 THE CURRENT SITUATION IN TENNESSEE

As discussed above, there is still work to be done on costs and rates before BellSouth can be said to have complied with the technical requirements of the law. The public interest issue is more complex. By allowing BellSouth into the long distance market, government regulators are saying that successful entry is now possible in the local telephone markets. While the laws, rules, and interconnection agreements have been written with that purpose in mind, as the saying goes, "the proof is in the pudding." How do we know that successful market entrants can emerge from the current environment? The best test, of course, is to see some evidence of it. At the current time, such evidence is thin. In Tennessee, it would be difficult to make a case

⁴ The Tennessean, "BellSouth expects 20% of long-distance market." January 30, 1997

⁵ Daniel F. Spulber, "Deregulating Telecommunications," *The Yale Journal on Regulation* 12:1 (1995).

today that a group of customers is receiving satisfactory local telephone service from a new facilities-based supplier who is meeting its business objectives (i.e. at least on the path to making a profit). While problems are to be expected in any start up business, regulators must determine whether the problems being encountered are normal to any business, or because an appropriate environment has not yet been created.

7.0 Comments on the Staff's Draft Report

Comments on the staff's January 31, 1997 draft report were received from AT&T, BellSouth, LCI International, LDDS WorldCom, MCI, NEXTLINK, Sprint and Time Warner (Appendices A through H). All of the parties agree that BellSouth has not yet met the requirements of Section 271 of the Act for entry into their regional long distance market. Beyond that, the new entrants and BellSouth part company on where things stand with respect to compliance with Section 271.

While the comments of the companies speak for themselves, the views are dramatically different. AT&T, for example, does not believe any of the items on the 14 point checklist have been met. BellSouth says they have all been met. With respect to facilities-based competition in Tennessee, all agree that the Track A option (271(c)(1)(A)) has not yet been met by BellSouth. BellSouth advises the TRA in its response that it plans to follow the Track B option in Tennessee. Some of the new entrants argue that the Track B option is not open to BellSouth.

The comments of NEXTLINK, the only new facilities-based provider of local telephone service in Tennessee, were of great interest to the staff. This is the only BellSouth competitor in a position at the moment to offer evidence on how implementation of interconnection agreements is going in Tennessee. While they acknowledge that Bell is working ". . . at a less than optimal pace . . ." to meet the requirements of the 14 point checklist, they do not believe that they have yet met those goals. NEXTLINK along with other commentators (e.g. AT&T) recommend that the TRA initiate a formal proceeding, to include discovery and a hearing, prior to making a recommendation to allow BellSouth entry into Tennessee's long distance market.